

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ADJUSTMENT OF RATES OF
SPANISH COVE SANITATION, INC. } CASE NO. 8487

O R D E R

On March 29, 1982, Spanish Cove Sanitation, Inc., ("Spanish Cove") filed an application for adjustment in its rates charged for sewer service. The proposed adjustment in rates would increase Spanish Cove's annual revenues by \$24,416, or approximately 178 percent. Spanish Cove stated that this adjustment was necessary to permit it to operate on a sound financial basis and to provide adequate service to its customers. The Commission in this Order has allowed an increase in revenues of \$6,957.

In order to determine the reasonableness of the proposed rates, the Commission held a public meeting in its offices on May 27, 1982. The Attorney General's Division of Consumer Protection and several customers of Spanish Cove were present and participated in the meeting. The additional information requested at the above meeting has been filed.

TEST PERIOD

Spanish Cove proposed and the Commission has accepted the 12-month period ending December 31, 1981, as the test period in this matter. Pro forma adjustments found reasonable have been included to clearly reflect current operating conditions.

VALUATION METHOD

The Commission has used the operating ratio method as the basis in determining sewer rates for the past several years and finds that the results of this method have been reasonable and fair to both utilities and ratepayers. Therefore, the Commission, after consideration of various methods, will use the operating ratio method, calculated as follows:

$$\text{Operating Ratio} = \frac{\text{Operating Expenses} + \text{Depreciation} + \text{Taxes}}{\text{Gross Revenues}}$$

REVENUES AND EXPENSES

Spanish Cove's income statement for the calendar year 1981 showed operating expenses (including interest expense of \$10,529) of \$25,215. Moreover, Spanish Cove proposed several adjustments to its income statement to reflect current operating conditions more accurately. The Commission accepts Spanish Cove's adjusted level of operating expenses and revenues with the following exceptions:

Excess Capacity

It was established in the record that the capacity of the sewer system is 225,000 gallons per day ("GPD") and that the present demand on the system is only approximately 37,200 GPD. The Commission finds that it is, therefore, unfair to require the present ratepayers of the system to pay the total cost of this excess capacity. The Commission, however, also recognizes that it may be several months or more before sufficient additional customers are served by Spanish Cove to reduce the fixed costs per customer associated with the excess capacity. In the meantime the plant must be operated in a safe and satisfactory manner. Therefore, the Commission is of the opinion that in fairness to all parties concerned the costs associated with the excess capacity should be shared equally among the utility and the ratepayers. Thus, the Commission has reduced Spanish Cove's adjusted operating expenses by \$7,966.^{1/} This apportionment, based on test year operations, should result in adequate cash flow to pay operating expenses and service the outstanding debt.

1/ Calculation:

| | <u>Book Amount</u> | <u>Excess Capacity*</u> | <u>Adjustment</u> |
|--------------|--------------------|-------------------------|-------------------|
| Depreciation | \$ 8,574 | \$3,575 | \$ 4,999 |
| Interest | 10,529 | 4,391 | 6,138 |
| Total | <u>\$19,103</u> | <u>\$7,966</u> | <u>\$11,137</u> |

*225,000 GPD - 37,200 GPD = 187,800 GPD ÷ 225,000 GPD =
83.47% x 50% = 41.7%

Revenues

Spanish Cove proposed to use its actual revenues earned in providing sewer service to its customers of \$13,717. The rates charged by Spanish Cove for sewer service are not the same as the rates authorized by its tariff. Moreover, Spanish Cove is presently billing an additional 24 apartment units for sewer service. Therefore, the Commission has increased Spanish Cove's operating revenues by \$3,995 to adjust revenues for the rates of Spanish Cove currently listed in its tariff and the additional apartment units now served.

Management Fee and Maintenance Expense

Due to insufficient revenues, Spanish Cove has not been able to reimburse its operator for services rendered nor to provide for normal maintenance and upkeep of the sewer system. The Commission is of the opinion that these are reasonable expenses to be incurred by a utility, and Spanish Cove should be allowed to recover them. Therefore, the Commission has included an allowance of \$2,400 for management fees and \$2,500 for maintenance expenses.

Legal Fees

During the test period Spanish Cove incurred legal fees of \$2,661 in connection with "nuisance suits." The Commission is of the opinion that these fees are not recurring expense items and should be amortized over a 3-year period. Therefore, the Commission has reduced Spanish Cove's legal fees by \$1,774.

Therefore, Spanish Cove's operations are stated as follows:

| | <u>Actual</u> | <u>Adjustments</u> | <u>Adjusted</u> |
|---|-------------------|--------------------|------------------|
| Operating Revenues | \$ 13,717 | \$ 3,995 | \$17,712 |
| Operating Expense (including interest) | 25,215 | (3,370) | 21,845 |
| Net Income/(Loss) | <u>\$(11,498)</u> | <u>\$ 7,365</u> | <u>\$(4,133)</u> |

REVENUE REQUIREMENTS

The Commission is of the opinion that a fair, just and reasonable operating ratio is 88 percent in that it will permit Spanish Cove to pay its operating expenses, service its debt and provide a reasonable return to the utility. Therefore, the Commission finds that Spanish Cove is entitled to increase its rates to produce total revenues of \$24,669, or an increase of \$6,957, which includes an allowance for Jefferson County and income taxes.

COMMENTARY

Spanish Cove has obtained two loans for financing improvements to the sewer system ordered by the Division of Environmental Health and for building the concrete structure for the 225,000 GPD sewer plant. Spanish Cove neither sought nor received the Commission's approval to obtain these loans and now requests that the Commission grant rates which in part have been necessitated by this financing. Utilities are required by 807 KAR 5:001(10) to obtain approval of this Commission before issuing evidences of indebtedness payable over more than 2 years.

While the Commission will grant an allowance for the interest expense to be incurred by Spanish Cove, subject to the finding of excess capacity stated above, it serves notice to Spanish Cove and all other utilities that unapproved financing may not be considered in the setting of rates in future rate increase proceedings, especially if the rate increase is necessitated by the acquisition of the unapproved financing.

SUMMARY

The Commission, after consideration of the evidence of record and being advised, is of the opinion and finds that:

1. The rates in Appendix A are the fair, just and reasonable rates to be charged for sewage service rendered by Spanish Cove, in that they will allow Spanish Cove to meet its reasonable operating expenses and to accumulate a reasonable surplus for equity growth.

2. The rates proposed by Spanish Cove provide revenues in excess of those found reasonable and should be denied upon application of KRS 278.030.

3. Spanish Cove should obtain prior approval of this Commission before undertaking debt obligations covering a period of 2 years or more.

IT IS THEREFORE ORDERED that the rates in Appendix A are the fair, just and reasonable rates to be charged for sewage services rendered by Spanish Cove Sanitation, Inc., on and after the date of this Order.

IT IS FURTHER ORDERED that the rates proposed by Spanish Cove Sanitation, Inc., be and they hereby are denied.

IT IS FURTHER ORDERED that Spanish Cove Sanitation, Inc., shall file with this Commission within 30 days of the date of this Order its revised tariff sheets setting out the rates approved herein.

Done at Frankfort, Kentucky, this 12th day of August, 1982.

PUBLIC SERVICE COMMISSION

Merlin M. Voth
Chairman

Katherine Randall
Vice Chairman

Jim Canavan
Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE PUBLIC
SERVICE COMMISSION IN CASE NO. 8487
DATED AUGUST 12, 1982

The following rates are prescribed for all customers served by Spanish Cove Sanitation, which is located in the southeastern portion of Jefferson County, Kentucky. All other rates and charges not specifically mentioned shall remain the same as those in effect prior to the date of this Order.

| <u>Rates</u> | <u>Monthly Rate</u> |
|---|---------------------|
| Single-Family Residence | \$ 15.30 per month |
| Each unit of Multi-Unit apartment building | \$ 11.50 per month |
| Each Building Unit of a Commercial Development | \$ 32.00 per month |